

Written Statement of
H. WALKER FEASTER III
INSPECTOR GENERAL
FEDERAL COMMUNICATIONS COMMISSION

Before the
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
of the
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES

On
FCC's E-rate Plans to Assist Gulf Coast Recovery: Ensuring Effective Implementation

October 6, 2005

EXECUTIVE SUMMARY

- The Federal Communications Commission (FCC) is using a variety of temporary rule waivers to allow the Universal Service Fund (USF) to be used in support of Gulf Coast rebuilding efforts.
- The Office of Inspector General (OIG) will provide oversight of the FCC's rebuilding assistance:
 - In the annual audits of the FCC's financial statements.
 - In audits of recipients of the USF benefits.
- The FCC's financial contribution to the rebuilding effort is via the Universal Service Fund (USF). OIG has specific concerns about the USF, and particularly the E-rate program, that will have a direct impact the disaster assistance funding.
 - The audits and investigation performed to date indicate a high level of risk for misused funds in the E-rate program.
- OIG is committed to meeting our responsibility for providing effective oversight of the USF.

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to come before you today to discuss the FCC's plans for participation in Hurricane Katrina rebuilding activities and our plans to provide oversight of these activities. Last week I participated in a panel before this subcommittee, in which we discussed plans of several Inspectors General for providing oversight of their agencies Katrina related efforts. Today I will expand on some of the topics touched upon in my testimony from that date, and provide additional information on my Office's plans for oversight of the FCC's assistance in rebuilding in the wake of Hurricanes Katrina and Rita. Since the majority of the actual funds used by the FCC in the recovery efforts will come from the Universal Service Fund (USF), I will place emphasis on the plans to use the USF, and particularly the E-rate fund, in the rebuilding efforts.

FCC Use of the USF in Katrina Rebuilding Support

The Commission took the unprecedented step of holding an Open Meeting in Atlanta, Georgia on September 15, 2005. At this meeting, the Commission announced that it would use \$211 million of funds from the USF to assist recovery efforts in the disaster area. The FCC will use the four existing support mechanisms of the USF to provide this assistance, as follows:

- The Low Income program will be used to provide evacuees and persons in the affected areas still without telephone service wireless handsets and a package of 300 minutes. This fund will also be used to provide support for reconnecting consumers

as the area is rebuilt. The FCC has estimated this will amount to \$51 million of Low Income support.

- The Rural Health Care program will allow public and for-profit health care providers to apply for assistance with the cost of telecommunications services under relaxed participation requirements. The FCC has estimated this will amount to \$28 million of Rural Health Care support.
- The Schools and Libraries program (or E-rate) will be used to reconnect schools and libraries in the affected areas to telecommunication and network services. Using a variety of program rule waivers, the FCC will be able to authorize an estimated amount estimated of \$132 million in E-rate funds for the 600 schools and libraries hit by the hurricane.
- The High Cost program will allow greater flexibility for telephone carriers to use high cost funds to prioritize facilities affected by Katrina.

On September 21, 2005 the Commission issued an Order that provides some details on how this support will be facilitated. In this Order, numerous filings for various forms and information under the USF support mechanisms were postponed for a period of up to 150 days, including:

- For the E-rate program, responses to information requests from the Universal Service Administrative Company (USAC) relating to funding applications, formal requests for extensions of service delivery deadlines and service substitutions, and filings related to actions seeking recovery of funds disbursed in violation of program rules.

- For the Low Income Program, numerous filings that provide information related to the calculation and receipt of funding.
- Filings that support carrier contributions to the USF.

These temporary waivers are in effect from August 29, 2005 to January 26, 2006. In addition, the Commission has waived recordkeeping requirements pertaining to those entities in the Katrina affected areas.

The Commission has also stated that they will distribute additional funds in the hurricane affected areas by setting all schools and libraries in the disaster area at the 90% level of support, which is the highest level of support available under the program, in FY 2006. They will open a new 2005 funding window for schools and libraries in the affected areas to request new or additional support, and they will allow schools and libraries serving evacuees to amend their 2005 funding to account for increased student populations.

The Commission is currently drafting additional regulatory relief that will be needed to implement aspects of the Commission's plans. My Office has been requested to review and provide comment on the proposed actions.

Other Rebuilding Support by the FCC

The Commission has also announced the creation of a new Bureau – the Public Safety/Homeland Security Bureau. This Bureau will be comprised of existing functions

currently in other FCC bureaus and offices and will have responsibility for the FCC's public safety, national security, disaster management programs.

Additionally, the Commission has undertaken several actions that allow the telecommunications industry regulatory flexibility in rebuilding efforts. Through the issuance of temporary rule waivers and special temporary authorities, the FCC is assisting in re-establishing emergency communications, providing assistance and relief to television and radio stations in getting back on the air, extending regulatory fee payments, extending filing due dates for licensees, and performing a host of activities to contribute to the recovery efforts. The FCC is coordinating with the Federal Emergency Management Agency and the National Communications System, as well as state and local governments and organizations to communicate the FCC's flexibility in eligibility standards and processes to aid in the Hurricane Katrina relief efforts.

Audit Oversight of the FCC's Katrina-related Efforts

I applaud the Commission's efforts to be a positive force in the post-Katrina recovery, and I am supportive of all that this agency can do to assist. However, I am mindful that in my role as Inspector General, I am responsible for ensuring that these relief efforts do not present unacceptable risks to the agency and the taxpayer's dollar. I would like to discuss my plans for oversight of the FCC's Katrina-related efforts.

The myriad of rule waivers and special temporary authorities the Commission is granting for such areas as the resumption of radio and television broadcasting and regulatory licensing has only a small impact on audits conducted by my office. I have received estimates from agency management that indicate that efforts related to disaster recovery will cost approximately \$400 thousand in appropriated funding for personnel costs and contracted efforts. The Commission does not anticipate requesting additional budgetary resources for disaster recovery efforts.

Our primary audit role in these functions is to ensure that adequate internal controls are in place and operating effectively to ensure regulatory compliance and that financial cost accumulation and reporting is current, accurate and complete. While the reorganization and formulation of a new bureau carries a higher level of risk, our concerns are the same – are the financial and operational controls in place to ensure that the agency's programs and functions are operating in an effective and efficient manner and in compliance with applicable laws and regulations. My financial statement audits for FY 2005 and 2006 are the best tools I have available to make this assessment. My staff is coordinating with our contracted independent public auditors to ensure that testing under our financial statement audit will address any concerns.

One area of relief that impacts an area of audit concern for my Office is the extension of filing deadlines for payment of annual regulatory fees. The Commission has provided regulatees in the affected areas an extended deadline for the payment of regulatory fees. My Office currently has in progress an audit of regulatory fee collections and we will

incorporate additional tests into this audit to ensure compliance with the deadline extension granted by the Commission. Additionally, we are considering adding a review of the Emergency Alert System to our FY 2006 Audit Plan to determine if it operated as effectively as possible during the hurricane event.

OIG Oversight of the USF Katrina Funding

The FCC's financial contribution to the recovery is via the USF. My concerns about the USF, and in particular the E-rate program, have been the subject of numerous discussions with agency management, and several audit reports and semiannual reports issued by my Office. We have testified before this Subcommittee on three occasions, as well as other House and Senate committees, about concerns regarding the E-rate program. I will summarize the four parts of the USF and our efforts to provide oversight of the fund. In this discussion, I will focus on how concerns we have had about this program may generate higher audit risks associated with the hurricane recovery efforts.

Due to materiality and our assessment of audit risk, we have focused much of our attention on the USF mechanism for funding telecommunications and information services for schools and libraries, also known as the "Schools and Libraries Program" or the "E-rate" program. The E-rate program has expended \$10 billion since its inception in 1998. Our involvement in E-rate audits and investigations has highlighted numerous concerns with this program.

Our E-rate oversight program is designed around two corollary and complementary efforts. First, we would conduct audits on a statistical sample of beneficiaries large enough to allow us to derive inferences regarding beneficiary compliance at the program level. Second, we would establish a process for vigorously investigating allegations of fraud, waste, and abuse in the program.

The primary obstacle to our implementation of effective and independent oversight of the E-rate program has been a lack of adequate resources to conduct audits and provide audit support to investigations. Despite limited resources, the OIG has implemented an aggressive independent oversight program. My oversight program includes: (1) audits conducted using internal resources; (2) audits conducted by other federal Offices of Inspector General under reimbursable agreements; (3) review of audit work conducted by USAC; and (4) active participation in federal investigations of E-rate fraud.

To date One-hundred and fifty-eight (158) audits have been completed by the OIG, USAC internal auditors, or USAC contract auditors in which the auditors have reached a conclusion about beneficiary compliance. Of the 158 audits, auditors determined that beneficiary were not compliance in 34% of the reports issued. Recommended fund recoveries for those audits where problems were identified total nearly \$18 million. Additionally, we are providing audit support to 26 investigations into E-rate fraud allegations and monitoring another 13 investigations. There have been successful criminal prosecutions for E-rate fraud and settlement recoveries in excess of \$30 million.

The audits and investigation performed to date indicate a high level of risk for misused funds in the E-rate program. We have specific concerns about the E-rate program that will have a direct impact the disaster assistance funding, and I would like to highlight some of these issues.

For example, we have cited a lack of clarity in the program's rules as being a catalyst for both inadvertent errors and deliberate fraud, waste and abuse. We believe that it is critical that participants in the E-rate program have a clear understanding of the rules governing the program and the consequences that exist if they fail to comply with those rules. In circumstances under which additional rule waivers are laid on top of existing ambiguities, the potential for either accidental or intentional noncompliance with the rules and abuse of the Fund is dramatically increased.

We believe that it is possible under the current structure that applicants may not have a clear understanding of program rules. We are concerned that the Commission has not determined the consequences of beneficiary non-compliance in many cases and that, in those instances where the Commission has addressed the issue of consequences for non-compliance, the consequences associated with clear violations of program rules do not appear to be consistent. In some cases, USAC has implemented numerous policies and procedures to administer the E-rate program that the Commission has not adopted these USAC operating procedures and therefore, there is no legal basis for recovery of funds when applicants fail to comply with these procedures. To further complicate matters, we

have been advised that, in some cases, USAC may have exceeded their authority in establishing program requirements.

We have also described weaknesses in the competitive procurement requirements used to purchase E-rate goods and services and the ineffective use of purchased goods and services. Program rules require that applicants use a competitive procurement process to select vendors, to preclude instances where prices charged to schools and libraries are needlessly high and the Fund is unable to provide support to eligible schools and libraries.

Although the programs competitive bidding requirements were intended to ensure that schools and libraries are informed about all of the choices available to them, we have observed numerous instances in which beneficiaries are not following the program's competitive bidding requirements or are not able to demonstrate that competitive bidding requirements are being followed. We question whether the rules are adequate to ensure a competitive process is followed. In addition, weak recordkeeping requirements to support the procurement process, as well as other aspects of the E-rate application, offer little protection to the program.

Since our involvement in this program, I have become increasingly concerned about efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits. It has been our observation that audit findings are not being resolved in a timely manner and that, as a result, actions to recover inappropriately disbursed funds are not

being taken in a timely manner. While it appears this situation may be slightly improved in the past year or so, I remain concerned about the Commission's support to resolving audit findings. In September 2004, I issued three draft reports on E-rate compliance at private schools in the Virgin Islands. The Commission did not provide timely responses to these drafts, and in fact, never formally responded to these draft reports. On August 18, 2005, I issued these reports in final without agency comments. Given the planned increase in the number of E-rate audit reports over the next several weeks and months, I have strong concerns at the Commission's ability to provide comment on draft reports and resolve audit findings.

Site visits are conducted during most E-rate beneficiary audits. Site visits are conducted for several reasons including to evaluate the eligibility of facilities where equipment is installed, to verify that equipment is installed and operational, and to verify that equipment is being used for its intended purpose. Examples of concerns identified during audits and investigations are as follows:

- Goods and services not being provided.
- Unauthorized substitution of goods and services.
- Goods and services being provided to ineligible facilities (e.g., non-instructional building including dormitories, cafeterias, and administrative facilities).
- Equipment not being installed or not operational. Program rules require that nonrecurring services be installed by a specified date. However, there is no specific FCC rule requiring beneficiaries to use equipment in a particular way, or for a

specified period of time, or to full efficiency. Commission staff have provided guidance stating that if the equipment was uninstalled (i.e., still in a box) that would represent a rule violation. However, Commission staff has also provided guidance stating that the rules do not require that beneficiaries effectively utilize the services provided or that the beneficiaries maintain continuous network or Internet connectivity once internal connections are installed.

In addition to the concerns listed above, we have on-going concerns regarding the program's over reliance on self-certification by participants, weaknesses in technology planning, discount calculations and beneficiary payment of their share of the costs. I am concerned that the kinds of programmatic weaknesses I have described will be compounded by the confusion of overworked school and library administrators trying to rebuild shattered information systems under less than ideal circumstances in the hurricane affected areas.

Additionally, I fear these rule waivers or exemptions will be taken advantage of by unscrupulous E-rate service providers that federal criminal investigations have turned up time and again. Since the inception of the E-rate program in 1998, over \$184 million has been expended in Louisiana, and over \$79 million in New Orleans alone. As well as E-rate funds, the High Cost program has expended \$555 million in the state of Louisiana since 1998. Rebuilding the shattered infrastructure is critical. The financial needs will be huge and the risk of misspent funds must be taken into account. This level of funding

will certainly attract the less honest service providers to the area who might hope to take advantage of the additional funds being expended under relaxed rules.

I have mentioned the lack of resources my Office has struggled with in our work to provide effective and independent oversight of the E-rate program, as well as the other USF support programs. We have requested appropriated funds in our last three budget requests to Congress and have been supportive of efforts to provide the Commission with access to the USF for oversight funding. In addition, we are working with USAC Internal Audit department (IAD) and a public accounting firm under contract to USAC to conduct audits of One-hundred (100) E-rate beneficiaries. This project was initiated in August 2004 and is expected to be completed in FY 2006.

The round of 100 audits is being conducted under a relationship with USAC and the public auditors that could be described as semi-formal, at best. OIG is not a party to the contract between USAC and the contracted auditors and our participation is documented only in the engagement letter. We believe that our participation in this process would be enhanced by a more formal partnership between the Commission, USAC and the contracted auditors.

Our most significant effort to date to implement our E-rate oversight program has been our on-going work to establish a three-way contract under which the OIG and USAC can obtain audit resources to conduct USF audits. Under this contract, we intend to conduct the body of audits necessary to assess fraud, waste, and abuse at the program level by

conducting a statistically valid sample of audits for each of the four USF funding mechanisms. An additional objective is to identify improper payments as defined by the Office of Management and Budget to estimate error rates for the Improper Payments Improvement Act of 2002 (IPIA). Unfortunately, this project has been delayed. A Request for Proposal for this contract was issued in November 2004. The proposal evaluation process was completed, a contractor was selected and USAC submitted the proposed contract for Commission approval in April 2005. The proposed contract was held up in the transition between the former FCC Chairman and Chairman Martin, as the Chairman wanted to give this procurement detailed review prior to approval. Recently, we were provided a memorandum that lists concerns that the FCC Office of General Counsel has regarding the contractor selection process. Given the issues raised by the General Counsel, I have agreed, along with the Managing Director of the FCC, the Chief of the Wireline Competition Bureau and the General Counsel, that recompeting this contract is necessary to protect the interests of the fund and the integrity of the procurement process. The Chairman has recently expressed support for this three-way agreement and we believe that the contract will move forward in the very near future.

USAC is contemplating further audits to meet their oversight responsibilities, and we may be invited to participate in the same manner as we are in the current round of 100 audits. While this arrangement is less than ideal, it does allow for E-rate compliance audits to continue. Our auditors will incorporate appropriate steps in the audit work programs currently in use to ensure the Katrina rule waivers are considered in audit planning and fieldwork. We will continue to work in close coordination with USAC

internal auditors, independent auditors under contract to USAC, and other federal auditors conducting E-rate audits under interagency memoranda of understanding. We will ensure that the special risks that the FCC's proposed rules bring are addressed in the conduct of future audits.

However, the current working relationship we have with USAC IAD and the three-way contract are both solutions that could be described as second best. As we have stated previously, limited resources have precluded our ability to implement our planned oversight of the USF. Our preferred method of providing oversight of the USF program is for OIG to have direct access to the Fund for our use in implementing an independent oversight program. Any oversight program of the magnitude encompassed by the three-way agreement presents management challenges for our office. The audit supervision and quality assurance necessary for an audit program of this size is a major effort, and I do not have adequate staff to perform this work. I have requested funds in my 2006 and 2007 budget requests for additional staff and contract resources to assist in the management of this audit program; however, I would reiterate my support for enabling OIG to use the USF as the source of funds for this work.

Because we have focused our limited resources on the E-rate program, we have not been able to devote a great deal of attention to the other USF mechanisms. The other large USF program is the High Cost program. This program provides support to telecommunication carriers to ensure that consumers in all regions of the United States have access to and pay rates for telecommunications services that are reasonably

comparable to those services provided and rates paid in urban areas. This program has averaged over \$2.5 billion in annual expenditures and my office is aware that we need to expand our oversight in this area. However, we have not had the resources to establish an effective oversight program. In the breakdown of the \$211 million of Katrina relief there does not appear to be additional funds contemplated for High Cost and I believe that the primary effect of the Katrina support will be the redistribution of existing support. At the present, we are assessing risks in the High Cost program in anticipation of being able to institute an audit program in the future and will ensure our plans address any considerations brought by the Katrina relief.

The proposed Low Income disaster relief is very interesting, in that it seems to represent an entirely new use of this Fund. The Low Income program assists eligible low-income consumers to establish and maintain telephone service by discounting services provided by local telephone companies. The USF reimburses the telephone companies for the discounts under the Low Income program. This program provided \$759 million in support in 2004 and is considered to be of lower audit risk than the E-rate or High Cost programs. To the best of my knowledge, this support mechanism has not been used to provide wireless handsets and free minutes of service in the past. We will include an audit in our FY 2006 Audit Plan to determine how eligibility for this help is determined and verified and measures the Commission has taken to ensure the products provided are in the hands of the people who need the help.

The Rural Health Care program is the smallest USF program, having disbursed \$38

million since 1999. The FCC's proposed \$28 million of disaster assistance to emergency health care providers in the affected region will represent a dramatic increase in Rural Health Care expenditures. This is being accomplished by increasing the discount rate, which is the portion of costs covered by the support mechanism to 50% for qualified providers in the affected areas and for health care providers providing assistance to disaster victims nationwide. Additionally, the FCC will allow health care providers to file new or amended applications for funds in the current year. We are still assessing the requirement for oversight represented by the additional disaster relief funds.

Conclusion

The Office of Inspector General has been and remains committed to meeting our responsibility for providing effective independent oversight of the USF. My office will dedicate as much of our resources as possible to ensure that the extra measure of support provided by the Commission is utilized in a manner that best benefits the people whose lives have been so horribly uprooted by Hurricane Katrina.

Thank you. I will be happy to answer any of your questions.